Reverse Charging Purchases to Intra-transportation Means in the Context of New Tax Regulations

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REVERSE CHARGING PURCHASES TO INTRA-TRANSPORTATION MEANS IN THE CONTEXT OF NEW TAX REGULATIONS

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Abstract: New tax rules with effect from 1 May 2009 with a series of changes on the tax deductibility of the value added acquisitions related to transport and fuel use. The measure is very obvious nature of politics in order to bring the state budget amounts as required under the current government crisis in the financial world. The book focuses on not commenting policy modifications as required on the implications that they bring in on the accounting chargeback. Therefore, in the paper we will address the resolution of these legal provisions in the economic accounts.

1. Introduction

The new government has found (or thinks so) after many efforts, the solution for overcoming the financial crisis that surrounded the entire world: it introduced starting with 1 May 2009 a single legal provision in content and form for our country, governing the minimum tax in Romania [1].

Therefore, any legal person who had applied before that date the Tax Code provisions regarding the income tax or micro-enterprises income tax, from now on will have to pay off the state budget (and thus fill "the bag that kept getting empty") a minimum tax depending on the total income obtained in the previous year, i.e. 2008.

This regulation is valid only until 31 December 2010, being bitterly criticized by the media and entrepreneurs.

Even so, one effect of this regulation was obtained before the approval and publication of the implementing rules. Thus, even from the phase in which the government was propagating though the media its intention to introduce a law on the flat-rate or minimum tax, the number of firms, particularly small and very small (especially those which come under the category of micro-enterprises[1] [2]) that ceased or suspended activity in the Trade Register Offices throughout the country had an exponential evolution (even 10 times).

Perhaps this effect - we can call it the "Terminator" - will lead to "cleaning" only the firms which although registered in Trade Register Offices, were no longer conducing economic activities or have not conducted any activities since establishing and until present, or maybe it was one of the effects pursued by the Romanian state, but we believe

[1]According to Article 4 paragraph (1) (a) of Law 346/2004, "micro-enterprises have up to 9 employees and produce an annual net turnover or have total assets of up to 2 million euro, equivalent in lei".

that this cleaning process will also make many collateral victims. The future will confirm our point or not.

The theoretical principle and logic that are behind (or should be) the minimum tax law (as the main reason is the consistent growth of collected budgetary revenues) is an ideal one and is transposed as follows: It's **not quantity** (number of firms registered with the Trade Register Office) **that should be given priority, but quality** (health, efficiency, impact of activities on the level of living of the population, lucrativeness of the activities carried out by firms, etc.).

In other words, it's useless to boast statistically with the number of firms established each year after revolution, after a simple analysis we will find (as did the executive) that only about 40% of them are working, therefore contributing (or should contribute) to directly stimulate economic growth and provide high living (at the European level).

Given the subject of this paper (reverse tax implications), we will not dwell too much on this subject, but we will present at the end some comments and suggestions on the minimum tax.

Besides introducing a flat-rate or minimum tax, the new regulations bring significant changes in terms of value added tax related to purchases of fuels and vehicles (cars under 3500 kg and less than 9 seats), known as "special limitations of deduction right"[3].

Although the regulations set clear rules on the definition of acquisition concept and road motor vehicles (means of transport) for which is limited the right to deduct the VAT related, a problem remains unresolved, namely: how will the reverse charge apply from 1 May 2009 for the means of transport come from intra-Community acquisitions so as not to conflict with the new regulations?.

2. Short history of reverse charge applied in Romania

The reverse charge [4] was introduced starting with 01.01.2005 for transactions within Romania, among the VAT payers, with ferrous and non-ferrous metal waste, with lands or buildings or building parts or living animals.

Until 31.12.2004 beneficiaries were able to use the deducted tax for VAT payable or any other taxes and fees to be refunded or, in case they were exporters, they would require the VAT refund from the budget. It is well-known that during the cross-checks made on VAT refunds, more often than not it showed that suppliers which had to collect the VAT were bogus companies set up with the purpose of such fiscal schemes, prejudicing the state budget.

Currently two periods can be delimited, that is between 01.01.2005 (procedure entry date) and the accession date (01.01.2007), and after accession. We shall focus in this paper on the current period (after accession), also pointing out for comparison purposes the main aspects of the first stage.

For 2007, the application of the reverse charge is binding on the suppliers and beneficiaries registered for VAT purposes for the following goods/services:

a) woody material;
b) wastes and secondary raw materials, resulted from their disposal [6];
c) buildings, building parts and lands of any kind;
d) goods and/or services delivered or provided by or to the persons in bankruptcy declared by final and irrevocable judgment;
e) construction - assembly works;
f) intra-Community acquisitions (regardless of their nature).

Starting with 2008, the reverse charge is applied for:

a) woody material;
b) wastes and secondary raw materials, resulted from their disposal [6];
c) goods and/or services delivered or provided by or to the persons in bankruptcy declared by final and irrevocable judgment;
d) intra-Community acquisitions (regardless of their nature).

3. What is reverse charge?

The reverse charge procedure is not a Romanian artifice; it is used by many European countries to prevent the budget refund of amounts that it did not collect. [4]

The simplified procedure on VAT (reverse charge) [5] was imposed because of the alarming signals received from the business environment and from the territorial fiscal bodies, who have repeatedly required legal measures to control tax avoidance that is strikingly manifested in the trade with waste products and immovable property.

Practically, **operations remain taxable**, **but VAT is no longer actually paid among companies registered as VAT payers**.

Therefore, the state budget either does not collect the VAT in this operations, which is without prejudice, since the tax that should be collected by traders with ferrous and non-ferrous metal waste, lands or buildings or building parts should be deducted by the beneficiaries.

Moreover, the reverse charge may be applied on each stage of the economic circuit, regardless of how many shackles it passes through, but it is stopped when conditions are no longer met, that is one of the parties is not registered as VAT payer. Therefore the reverse charge is without prejudice to the state budget, because the main principles of the value-added tax are observed, that is this tax is paid by the final consumer.

Before accession, the reverse charge implied invoicing as for any other taxable operation, only with the side mention "reverse charge". In order to assess the value of the goods without VAT, suppliers would make the general accounting registrations, registering for the VAT amount the **VAT autoliquidation** (4426=4427). Both the supplier and the beneficiary registered the invoice in the sales journal and in the purchase journal, the amounts being properly taken over in the VAT return. Suppliers deduced the VAT entirely at the output tax level from the invoices issued for deliveries of goods for which there was the “reverse charge” mention, even if they were VAT payers with mixed regime.

Beneficiaries used to make (before accession) and they continue to make (after accession) the general accounting registrations for an acquisition of goods or for an advance payment, as the case may be, for the value of goods or, as the case may be, the advance payment, without value-added tax and for the VAT amount they made the registration 4426=4427.

After the VAT return, beneficiaries – VAT payers with mixed regime – record (both before and after accession), the non-deductible tax afferent to the pro-rata in the expense accounts of the current fiscal year if the destination of goods/deliveries is to fully or partly make operations that do not have a deduction right (VAT being fully/partly registered on expenses: 635 = 4426).

If they are intended for operations with deduction right, beneficiaries deduce the value-added tax entirely, without being influenced by the pro-rata.

In the seller's case, the value-add tax refund at the output tax level is similar to its collection, and for the purchaser, the value-added tax collection on the level of the tax recorded in the acquisition invoice is equivalent with its payment.

After accession, until now, the reverse charge implies only the “reverse charge” entry on the invoices issued for goods/services deliveries by the internal suppliers, without mentioning the afferent tax as well. On invoices received from suppliers, beneficiaries

mention the afferent tax that they emphasize both as output tax (4427) and as input tax (4426) (4426 = 4427).

In case of purchase agreements of goods with instalment payment, valid concluded, before 31 December 2006 inclusive, which are carried on after the accession date as well, the exigibility of tax for the due instalments after the accession date comes on each date specified in the agreement for the instalments payment. In the case of leasing agreement valid concluded before 31 December 2006 inclusive and which are carried on after the accession date as well, the interests for the due instalments after the accession date are not included in the tax base.

In the case of movable tangible goods introduced in the country before the accession date by the leasing companies, Romanian legal persons, on the basis of leasing agreements concluded with the users, Romanian natural or legal persons and which entered into a customs import procedure with exemption from payment of all the import rights value, including VAT, if purchased by users after the accession date, the regulations in force on the date of entry into force of the agreement shall be implemented.

The investment objectives finalized by a capital asset whose year following the operating one is the year of Romania's accession to the European Union are subject to the adjustment regime of the input tax.

The tax exemption certificates issued until the accession date for delivery of goods and provision of services financed from aids or non-callable loans, granted by foreign governments, by international bodies and by non-profit and charity organizations from the country or from abroad or by natural persons, keep their validity during the objectives process. Supplement of the tax exemption certificates are not allowed after 1 January 2006.

In the case of binding agreements concluded until 31 December 2006 inclusive, the legal dispositions in force on the date of entry into force of the agreement shall be implemented for the following operations:

a) research, development and innovation activities, for fulfilment of programs, subprograms, projects and actions included in The National Research, Development and Innovation plan, in the core programs and in the sectorial programs, legally functioning [7], and the research, development and innovation activities financed in international, regional and bilateral partnership;
b) construction works, management, repairs and maintenance of monuments commemorating miltants, heroes, war victims and victims of the Revolution of December 1989.

The legal dispositions in force after the accession date shall apply to the previously provided additional papers to the agreements concluded after 1 January 2007 inclusive.

For the good performance guarantees deducted from the value of construction -assembly works, emphasized as such in invoices until 31 December 2006 inclusive, shall be implemented the legal dispositions in force on the date these guarantees are made, as concerns the VAT exigibility.

For the real property works that finalize with an immovable asset for which the prime contractors opted that, before 1 January 2007, that tax payment should be made on the date of the immovable asset delivery, there shall be implemented the legal dispositions in force on the date this option was made.

Joint ventures of Romanian taxable persons and taxable persons established abroad, or exclusively of taxable persons established abroad, registered as VAT payers, until 31 December 2006 inclusive, in accordance with the legislation in force on the constitution date, are considered distinct taxable persons and remain registered for VAT purposes until the end of the agreements they were constituted for.

For the advance payments collected until 31 December 2004 inclusive for goods deliveries, there shall be applied the fiscal regime on value-added tax on the date of the advance payment collection. The operation of advance payments adjustment does not affect the reverse charge application on the date of goods delivery invoicing.

The value-added tax for the goods deliveries made with instalment payment until 31 December 2004 inclusive shall be adjusted as follows: suppliers, respectively beneficiaries cancel the value-added tax for the instalments whose due date comes after the date of 1 January 2005 registered in the 4428 account in correspondence with the customers / suppliers account, shall make the accounting registration 4426=4427 with the VAT afferent for each instalment, at each date stipulated by the agreement for the instalment payment.

If the supplier/provider did not mention "reverse charge" in the invoices issued for the classified goods/services, the beneficiary must apply the reverse charge and must not pay the tax to the supplier/provider, he must make the "reverse charge" mention in the invoice and fulfil the above-mentioned obligations.

The taxable person who had the right to entire or partial tax refund and who, on or after the accession date do not opt for the charge or cancel the charge option of any of the stipulated operations for an immovable asset or part of it, build, purchased, changed or modernized before the accession date, shall adjust the tax. The taxable person who did not have the right to entire or partial tax refund for an immovable asset or part of it, build, purchased, changed or modernized before the accession date, opting for the charge of any of the stipulated operations, on or after the accession date, shall adjust the afferent input tax.

If the competent fiscal bodies, upon the checks performed find that the simplification measures legally functioning [5] were not applied for these assets, they shall bind the beneficiaries to cancel the input tax through the suppliers' account, to make the accounting registration 4426=4427 and the registration in the VAT return drawn up at the end of the fiscal year when the check was finalized, in the adjustments lines. If beneficiaries are mixed taxable persons and the assets purchased are intended to make operations both with and without deduction right, the VAT input tax shall be determined on pro-rata basis on the date of purchase of the assets subject to reverse charge and it shall be registered in the adjustments line of the VAT return which is no longer affected by the pro-rata application from the current period.

The persons registered as VAT payers must submit to the competent fiscal bodies a VAT return for each fiscal year until 25th inclusive of the month following the one when the fiscal year ends. The VAT return shall include the amount of the input tax which gives rise to the deduction right in the reporting fiscal year and, as the case may be, the tax amount for which the deduction right is exercised, the amount of the output tax whose exigibility rises in the reporting fiscal year and, as the case may be, the amount of the output tax that was not registered in the VAT return of the fiscal year when the tax exigibility came into existence, as well as other information under the model laid down by the Ministry of Economy and Finance.

The unit draws up the centralizing registers of purchase and sales and the purchase and sales journals whose information represent the basis for drafting the value-added tax return.

We think it is necessary to mention that each taxable VAT payer must draw up and submit to the competent fiscal bodies informative and recapitulative statements regarding the intra-Community deliveries, acquisitions etc, that shall include a series of information concerning the total amounts for each supplier/customer, afferent to the activities performed etc., that is: 390 VIES Statement - Recapitulative Statement concerning the

intra-Community deliveries/acquisitions of goods, the Informative Statement 392 concerning the deliveries of goods and provisions of services, the Informative Statement 393 concerning the income obtained from selling tickets for international passenger road transport, with the departure from Romania, 394 - Informative Statement concerning deliveries/provisions and acquisitions performed within the country.

4. The implications of the new tax measures regulated in April 2009 on the reverse charge to the intra-Community acquisitions of means of transport (with effect from 1 May 2009)

In the VAT field, the European Directives as well as the Jurisprudence of the European Court of Justice were transposed into the draft law of amendment of Title VI of the Fiscal Code, the old legislation being replaced by the legislation harmonized with the Aquis Communautaire. [8]

The accession involved among other things the elimination of customs barriers between the EU Member States and implicitly abolition of border controls on movement of goods between these states. As a result, the export and import concepts disappeared in the relationship between the Member States, being replaced by new concepts such as intra-Community delivery instead of export and intra-Community acquisition, instead of import. The goods entered into a customs suspensive procedure are considered after accession as non-transfers. In the same time, the control on movement of goods between Member States is performed by the electronic system VIES (VAT International Exchange System) and on the basis of regulations that stipulate the conditions under which the Member States shall exchange information and multilateral controls in order to avoid fiscal fraud in the VAT field.

Since 1 May 2009, regulations on the reverse charge for intra-Community acquisitions of means of transport were not changed, but the new measures determine the consideration of VAT related to cars (no more than 9 passenger seats and a mass less than 3500 kg.) derived from intra-Community acquisitions, import and from Romania, which entered the property of economic operators after this time, as **non-deductible**.

The regulation [1] (including the implementing rules [3]) expressly provides the categories of means of transport (motor vehicles) for which the value added tax is still deducted, namely:

- vehicles used exclusively for:
  - intervention;
  - repair;
  - security guard;
  - courier services;
  - transportation of personnel to and from the work place;
  - vehicles specially adapted for use as camera trucks;
  - vehicles used by sales agents;
  - vehicles used by staff recruiting agencies.
- vehicles used to transport persons for compensation, including for taxi activity;
- vehicles used for the provision of paid services, including:
  - rental to others;
  - training by driving schools;
  - transmission of use under a contract of operational or financial leasing);
- vehicles used for commercial purposes, or for the purpose of resale.

Therefore, economic operators who qualify for the application of reverse charge for motor vehicles purchased in the EU (intra-Community acquisitions), as provided by laws [4] that were also applicable before 1 May 2009, will continue to apply such simplification

measures, and for vehicles (cars) that are not part of any category mentioned above (for intervention etc.) the related VAT will be in registered as non-deductible (635 = 4426).

The implications are obvious: there are stimulated purchases (from domestic, import and intra-Community, all together) of motor vehicles without which certain activities could not be carried out (freight transport, security, taxi, driving schools etc.) or which are the object of activity of economic operators, at the expense of purchases of cars (luxury mostly) mostly used for personal purposes (very often these vehicles appeared in legal person's ownership but were used by individuals - executives - bringing benefits only to the latter, being actually an extension of their property, even if the financial effort - acquisition, fuel, insurance, repairs etc. - fell entirely under the legal person's responsibility).

5. Conclusions, suggestions and comments

Regarding the subject of this paper **we can conclude** that reverse charge is maintained whereas Romania must apply the Aquis Communautaire, but also restricts the right to deduct VAT related to intra-Community acquisitions of means of transport by entities paying VAT (with some exceptions established by GEO 34 / 2009: vehicles used for repair, intervention, courier, freight transport etc.) and therefore after the registration of VAT self-liquidation, entities are forced to reflect in their accounts the prohibition on its deduction (635 = 4426).

Or, if intra-Community operations are taxable in terms of VAT - through self-liquidation of related VAT - however, the new regulations do not allow anymore to deduct VAT for road motor vehicles provided by Article 145[1] of the Tax Code as amended by EGO 34/2009, that are acquired[2].

Although we do not want to comment on this "invention", we shall briefly present the following **suggestions and comments**:

- the regulation is discriminatory because it is not applicable to all companies[3] [3]. Thus, given that during the suspension of work the application of minimum tax is also suspended, there are two periods clearly defined and two cases for 2009 (obviously discriminatory):
    a) companies have suspended work (are in temporary inactivity registered in the Trade Register) **before 30 April 2009, inclusive**, shall not apply the new regulations on the minimum tax (only the provisions relating to VAT shall be applied), even if from 1 May 2009 (or any other time until 31 December 2009) they resume activity (cease the temporary period of inactivity);
    b) in the same time, companies that have not conducted economic activities from their founding until now, but have not entered into temporary inactivity by 30 April 2009, inclusive, and the other companies that have conducted activities (profitable or not) must calculate and pay the minimum tax according to the total revenue registered in 2008, even if they suspend work (temporary inactivity) after 1 May 2009 and cease this inactivity until the end of 2009.

  In other words, a company that registered revenues in 2008 (no matter how big or small), but had the "luck" (still pretty big coincidence) to enter into temporary inactivity on 30 April 009, will be able to ignore completely the legal provisions on the minimum tax by the end of 2009 (great!), even if it resumed work on 1 May

[2] Acquisition of vehicles means the purchase of a vehicle in Romania, its import or ***intra-Community acquisition***.

[3] Point 11^5 and 11^6 of the Government Decision no. 488/28.04.2009.

2009, applying in exchange the previous regulations set by the Tax Code on tax income[4] or micro-enterprises income tax, as appropriate. Meanwhile, other companies, not as lucky, shall apply the minimum tax even if they suspend after 1 May 2009 and then resume activity until 31 December 2009[5]. Where is the equality of treatment and why should there be such discrimination? We could not understand this yet.

- even if we support the application of a minimum tax in Romania, we think it should have been established on progressive portions (as there was once tax income in 2004) based on annual turnover and not a fixed tax based the total annual income;
- Obviously there were many companies that did not pay any tax as they declared zero profit (or permanent loss), or hiding their income through tax avoidance techniques, but the measure imposed proves once more (I did not believe it was necessary) that *the state is not able through its control bodies and institutions to combat tax evasion and corruption*;
- if the state can not take control of tax evasion (which seems to bloom more in this period of crisis) we think it was more appropriate to establish a fixed rate tax (normal) according to the NACE code of activity undertaken by firms in Romania, with anticipated sampling (at the beginning of the year or of activity) in the state budget, on the principle that whoever can not provide a minimum efficiency (the profit and payment of all debts) would better cease work (liquidation, bankruptcy, etc.). Only truly efficient firms would conduct business under these conditions, and all that the control bodies of the state can do is to follow up the collection of budgetary revenues (not the calculation and reporting) and to catch those who are likely to conduct illegal activities (on the black market). This would be possible, given that the economic operators remaining active in the market (much fewer, about 60% of the operators active on 30 April 2009) could be more easily verified by the control bodies (the control would take only 1% of the time currently required) and the remaining time could be used to eradicate the black or gray economy;
- the same could be for the income from wages, as taxation by a single fixed rate has the same beneficial effects (high collection degree and ease of control). The assumption is based on the following fact: there are now at least 4 legal deductions and 6 contributions related to income obtained by employees and given by employers as salary (compared to one proposed by us). If we also add the possibility to waive the contributions, there are already more efficient alternatives to the private sector, namely life insurance companies etc., there would be only one impediment: accountability of citizens in the sense that they should "come of age" and not depend on social measures from the state (equivalent to "caring parents"). It's famous and proved that no individual (including from animal kingdom, without any hint) becomes independent as long as there is someone (parents, the state, relatives, friends etc.) that protects him/her (like the mother under whose skirt the child hides and protects himself from the external environment that is harsh, cruel and merciless) and urges him/ her not to seek one's ways of protection and not to trouble thinking (it's easier to have someone else think in your place);

[4] Thus, these companies shall not pay anything to the state budget if they declare that they have tax losses (and we all know how these statements are true and how correctly are determined the taxable earnings in Romania).

[5]They shall pay the minimum tax even if in 2008 they had losses or had no income at all (2200 lei / year), and it doesn't matter if currently until the end of 2009 they have tax losses (quite shocking).

- all these, accompanied by implementation of really harsh punishment against tax evasion and rapid liquidation of firms that fail to pay their duties to the state (fixed tax for each classification code of economic activities carried out in Romania and the fixed rate tax applied to a minimum wage for each type of salary activity undertaken) would certainly lead to the alignment of the living in Romania with the living in developed countries of the European Union, including the rapid accession to its structures. *Hoping that we will not be misunderstood*, we think that the Romanian state should show courage and perseverance, moving to facts and not just talk about eliminating tax evasion (like Hitler who declared war to Jews and sought the creation of pure breed: Jews would be the synonym of tax evasion, Hitler the synonym of the Romanian state that can create "pure" economic operators).

Finally, let's reiterate that this measure is discriminatory, insufficiently substantiated, with discriminatory provisions, applied in haste, inappropriately propagated though the media (what if everyone - individuals and legal persons - understood that in order to cope with the crisis we should first of all be willing to make sacrifices?) based only on the state interest to patch somehow the budget impoverished by the financial crisis (we know what happens when at a cart "oxen" don't pull in the same direction, so all we can do is wait to be "surprised" by the "beneficial" effects of this regulation).

References

[1] Government Emergency Ordinance no. 34 from 11/04/2009 concerning the budgetary correction for 2009 and for the reglementation of fiscal and financial measures, published in MO no. 249/14.04.2009.

[2] Law no. 346 from 14/07/2004, for stimulating the establishment and development of small and medium enterprises, approved with amendments and changes by O.U.G. no. 139/2007, published in MO no. 844 from 10/12/2007.

[3] Government Resolution no. 488/28.04.2009 for supplementing of the Methodological Norms for applying the Law no. 571/2003 regarding the Fiscal Code, approved by Government Resolution no. 44/2004, published in 30/04/2009, MO no. 286/30.04.2009.

[4] Ecobici Nicolae, „Fiscal and accounting aspects concerning the reverse charge in the context of accession to the European Union", Competitiveness and European Integration, Cluj Napoca, Babes Bolyai University, Romania, October 26-27, 2007, indexed in the database of international REPEC, Online at http://mpra.ub.uni-muenchen.de/8012/

[5] Fiscal Code, Title VI, Article 160^1 simplification measure in the VAT field in order to control tax avoidance.

[6] Government Emergency Ordinance no. 16/2001 on the management of recyclable industrial waste, republished, as further amended and supplemented.

[7] Government Ordinance no. 57/2002 concerning the scientific research and technological development, approved with amendments and changes by Law no. 324/2003,

as further amended and supplemented.

[8] Sixth Directive, or Council Directive 77/388/EC of 17 May 1977, on the harmonisation of the laws of the Member States relating to turnover taxes - common system of value added tax: uniform basis of assessment, published in the Official Journal of the European Communities (OJ) no. L 145 of 13 June 1977, with its subsequent changes and amendments.